

Internal Revenue Service  
Director, Exempt Organizations  
Rulings and Agreements

Department of the Treasury  
P.O.Box 2508, EODQA Rm. 7008  
Cincinnati, OH 45201

Date:

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code. We have concluded that you may qualify under section 501(c)(2) of the Code, but you do not wish classification under that subsection.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a Trust, or Form 1120 if you are a corporation or an unincorporated association. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues." The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice

Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides, in part, that:

A declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination. In that event, appropriate State officials will be notified of this action in accordance with the provisions of section 6104(c) of the Code.

Sincerely,

Lois G. Lerner  
Director, Exempt Organizations  
Rulings and Agreements

Enclosures: 4

## Enclosure I

X=

A=

B=

C=

Facts:

You are organized as a non-profit corporation in the State of X. Your Articles of Incorporation state, in general, that you are organized exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes. Your Articles specifically state that you were organized exclusively to develop, on a non-profit basis, a housing project for persons of low income.

Your initial application (Form 1023) appeared to indicate that you would be actively involved in the production and operation of low-income housing. However, information subsequently submitted in response to our requests for clarification of your activities disclosed that your only activity would be to hold title to three buildings, comprising 52 apartments. The apartments will provide affordable housing for low-income individuals/families and for senior citizens. You obtained title to the land from the X Department of Housing Preservation and Development for a nominal sum. A limited partnership (the A Limited Partnership, hereafter "Partnership") has the responsibility for constructing and operating the project. You assigned your rights in the property to the Partnership. You describe your role as the project "watchdog" responsible for ensuring that the development is constructed and operated in accordance with affordable housing regulations.

In your application, you indicated that you would be supported by government grants and donations from corporate foundation, with income and expenses approximately \$3,500 - \$6,000 a year. Your expenses would be for miscellaneous items such as rent, part-time salaries, office supplies, etc. You describe your budget as "limited to oversight expense" rather than "operational expense."

You were created by B, which is your sole member. B is tax-exempt under Code section 501(c)(3) and is the developer and sponsor of the project. The General Partner of the Partnership is C, which is a for-profit subsidiary of B. There are two Limited Partners, both for-profit entities.

In your response to our letter dated February 18, 2003, you confirmed that: Title to the property is the only activity that you will conduct. You were created by B solely for the purpose of holding title to this property. You will not hold title to property for any other organization.

Law:

Section 501(c)(2) of the Code exempts from federal income tax corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under section 501.

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

In Moline Properties, Inc. v. Commissioner, 319 U.S. 436, 438 (1943), the court held that for federal income tax purposes, a parent corporation and its subsidiary are separate taxable entities so long as the purposes for which the subsidiary is incorporated are the equivalent of business activities or the subsidiary subsequently carries on business activities.

In Britt v. United States, 431 F.2d 227, 234 (5<sup>th</sup> Cir. 1970), the court emphasized that where a corporation is organized with the bona fide intention that it will have some real and substantial business function, its existence may not generally be disregarded for tax purposes.

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 179, the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

In HCSC-Laundry v. United States, 450 U.S. 1 (1981), the Supreme Court held that the Internal Revenue Code section under which cooperative hospital service organizations are specially exempted (section 501(e)) was the exclusive provision under which such an organization could qualify under section 501(c)(3) as an exempt

organization organized and operated exclusively for charitable purposes. Because section 501(e) did not mention laundry, the nonprofit corporation at issue, which operated and maintained a hospital laundry and linen supply program for public hospitals and other exempt hospitals or related health facilities, was not entitled to tax exemption under the general section 501(c)(3). The Court reasoned, in part, that it is a basic principle of statutory construction that a specific statute, here section 501(e), controls over a general provision such as section 501(c)(3), particularly when the two are interrelated and closely positioned, both in fact being parts of section 501 relating to exemption of organizations from tax.

Knights of Columbus Building Association of Stamford, Connecticut, Inc. v. United States, 61 A.F.T.R.2d 1212 (D.Conn. 1988), held not exempt under section 501(c)(2) or (8) of the Code a corporation formed by an unincorporated exempt fraternal organization described in section 501(c)(8). The corporation was formed as a convenient means to hold title to and maintain real property used primarily by the fraternal organization in furtherance of its mission and partly for rental to outside organizations. The Service denied 501(c)(2) exemption to the corporation because it operated a bar and buffet business in addition to holding and maintaining the property. The court rejected the corporation's argument that the organization was described in section 501(c)(8) as an adjunct to the fraternal organization:

The issue becomes whether the adjunct doctrine, broadly stated, has general applicability. The court concludes that it does not. Section 501(c)(2) specifically exempts organizations that do largely what the Association does: hold title to property for exempt organizations. Because the Association cannot qualify under this section, it should not be entitled to skirt the prerequisites which title holding organizations must meet under the Code by asserting a non-statutory basis for exemption. This would undermine the intent of Congress. The adjunct doctrine has developed in unique factual settings which when reconciled do not stand for a general principle capable of eroding the statutory limitations on exemptions for each of the 25 types of entities described in Sections 501(c)(1)-(24)... The Association argues that it is so closely intertwined with the purposes of the exempt organization, that it is entitled to the same exempt status. This formulation would allow title-holding entities to stray from their title holding purpose and, therefore, from Section 501(c)(2), yet retain tax exemption. This application of the adjunct doctrine would render Section 501(c)(2) meaningless. Because Congress has by implication specifically precluded this result in Section 501(c)(2), the court will not countenance an end run around that section by way of the adjunct doctrine... [T]he adjunct cases involve fact patterns in which the adjunct performs a necessary and essential service to an exempt organization that the Code does not explicitly reach. In the present case the Association's central purpose is to hold

title to real property for a Section 501(c)(8) organization, a function which in Section 501(c)(2) the Code recognizes with strictures that cannot be ignored.

Id.

**Application of Law:**

Section 501(c)(3) of the Code sets forth two main tests for qualification for exempt status. An organization must be both organized and operated exclusively for purposes described in section 501(c)(3). You have satisfied the organizational test. You must, however, also satisfy the operational test. The key requirement is that an organization be operated exclusively for one or more exempt purposes.

The Service's main concern is whether you conduct a charitable activity to qualify for exemption under section 501(c)(3). The central question is whether holding title to a low-income housing project (your sole activity) is considered an exempt activity under section 501(c)(3) of the Code. The next question is whether the activities of B or the Partnership can be considered your activities for purposes of determining your qualification for exemption under section 501(c)(3) of the Code.

Your only activity is holding title to a low-income housing project. Holding title to property is not an activity that is within the purview of section 501(c)(3) of the Code. You retain legal title to the property; however, since you have no role in the operation of the Partnership, you are not conducting any activities that further an exempt purpose.

All of the activities that may qualify for exemption are being conducted through the Partnership. You are not a partner in the Partnership; therefore, none of the Partnership's activities can be considered your activities for purposes of determining exemption qualification.

Your claim for exemption is based on the fact that B, as the sponsor of the project and itself a 501(c)(3) organization, created both you and C to help further B's exempt purpose of providing low-income housing. The key question is whether the activities of B can be considered your activities for purposes of determining qualification for exemption under section 501(c)(3) of the Code. The activities of a parent (B) will not be attributed to the subsidiary (You) when both organizations are separate and distinct corporate entities with valid business purposes. See Moline, supra, and Britt, supra. B is a separate and distinct entity with a valid business purpose; therefore, its activities cannot be considered your activities for purposes of determining exemption qualification.

Since your only activity is to hold title to three low-income housing buildings for B, you may be described in section 501(c)(2) of the Code. Section 501(c)(2) of the Code exempts from federal income tax corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an exempt organization.

Your representative stated in a phone conversation on June 1, 2004, that you are not interested in receiving 501(c)(2) status. He stated that at the end of the 15-year compliance period, you would purchase the low-income housing facilities and in order to be the purchaser you must be exempt under section 501(c)(3). Section 14.02 of the Partnership Agreement gives the Right of First Refusal to B, not you.

In certain situations, an organization may claim the same exempt status as the exempt entity that created it because the created entity is deemed to be an adjunct, or integral part, of the exempt entity. These cases involve fact patterns in which the adjunct, or integral part, provides services that are necessary and indispensable to the exempt entity. Your purpose is to hold title to real property for an existing 501(c)(3) entity. This activity is specifically recognized as exempt under section 501(c)(2) of the Code. Because of the basic principle of statutory construction that a specific statute (here section 501(c)(2)) controls over a general provision such as section 501(c)(3), particularly where the two are so closely positioned as here, you are not deemed to be described in section 501(c)(3) of the Code. Similarly, you cannot be regarded as exempt under section 501(c)(3) as an adjunct, or integral part, of B. See HCSC, supra and Knights, supra.

Accordingly, based on all the facts and circumstances, we conclude that you do not qualify for recognition of exemption from federal income tax as an organization described in Section 501(c)(3) of the Code. You have not demonstrated that you are operated exclusively for exempt purposes.